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Strong and Cadwalader

Opinion with respect to the legality of a plan to...

[New York]

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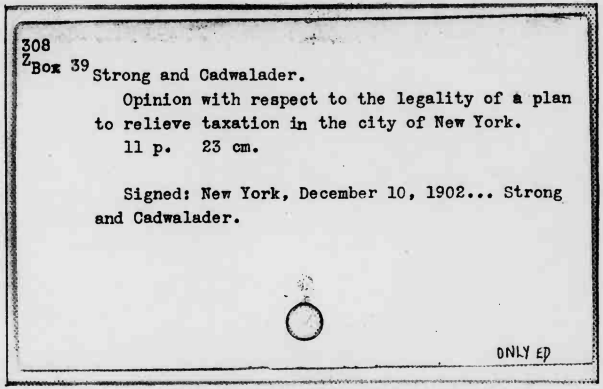
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OPINION

WITH RESPECT TO THE LEGALITY OF

A Plan to Relieve Taxation in the City of New York.

Strong and Carmichael

JAN 1 1 19[illegible]

JOHN HARSEN RHOADES, ESQ.,
President Greenwich Savings Bank,
16th Street & Sixth Avenue, New York.

DEAR SIR:—

At your request we have carefully examined the proposed plan "To Relieve Taxation in the City of New York," embodied in a letter from the Comptroller to the Mayor, dated September 22, 1902, and a letter from James W. Stephenson, Deputy Comptroller, to the Comptroller dated September 16, 1902, accompanying which is a proposed amendment to the charter of the Greater City of New York designed to carry out this plan.

You have asked us whether in our opinion this plan, if adopted, would be legal, or whether it would amount to a breach of the contract between the City and the holders of its securities for whose benefit the Sinking Funds referred to in the Plan were created.

The facts are, briefly, as follows: In 1844 two Sinking Funds were created by ordinance, one for the redemption of the City debt, and the other for the payment of interest thereon, by dedicating to these purposes respectively the income from certain designated sources, which funds were in effect consolidated in 1859 (Laws, Ch. 406) by transferring to the fund for the redemption of the debt the surplus revenues from that for the payment of interest.

In 1845 (Chap. 225) the legislature enacted that the ordinance of 1844 should not be amended without the consent of the legislature, except by appropriating to and for the purpose of the Sinking Fund additional revenue, and that the ordinance should remain in full force until the whole of the debt created for the introduction of Croton Water into the City of New York should be fully redeemed.

In 1878 the legislature further provided (Chap. 383) that the fund so created, which was known as "The

Sinking Fund of the City of New York for the redemption of the City debt " should be continued, and that

> " all moneys and revenues of said city heretofore
> " pledged and appropriated to and constituting
> " and *founding* said sinking fund shall continue to
> " be and the same are hereby pledged and appro-
> " priated to said fund until all of said bonds and
> " stock of the said city shall be fully and finally
> " redeemed."

This statute also contained the following provisions,

> " Sec. 4. Between the city and its creditors,
> " holders of its bonds and stocks, as aforesaid,
> " there shall be and there is hereby declared to be
> " a contract that the funds and revenues of the
> " city, and the funds to be collected from assess-
> " ments as aforesaid, by this statute pledged to
> " the sinking fund for the redemption of the city
> " debt, shall be accumulated and applied only to
> " the purposes of said sinking fund until all of
> " said debt is fully redeemed and paid as herein
> " provided."
>
> " Sec. 5. Nothing in this act contained shall be
> " held to require or authorize the commissioners
> " of the sinking fund to use or apply any part
> " or portion of the accumulations in said sinking
> " fund for the redemption of the city debt, or
> " the revenues of said fund, in any manner whatever
> " whereby the security of said fund for the pay-
> " ment of the bonds and stocks of said city, for
> " which said fund is now pledged by law, and
> " which are a charge on said fund, shall be *alien-*
> " *ated or impaired*, and the said bonds and stocks
> " so secured by law are hereby declared to con-
> " stitute a preferred charge on said sinking fund
> " until the same are fully and finally paid and
> " redeemed."

This contract was specifically adopted by the Greater City of New York upon its formation in 1898, and its charter provides in Sec. 204 that the Board of Commissioners of the Sinking Fund as thereby constituted

> " shall administer each of the said several sinking
> " funds and perform, carry out and exercise the
> " several trusts, powers, obligations and duties
> " relating thereto in the same manner as the same
> " would have been administered, performed, carried
> " out and exercised if this act had not been
> " passed, except as otherwise provided in this
> " act."

It further appears that the revenues from the Sinking Fund have increased far beyond anything which was anticipated either when the ordinance of 1844 or the Act of 1878 was passed. It does not appear that there has been yet accumulated in the Sinking Fund a sufficient amount to redeem all of the outstanding stock entitled to the benefits of it, but the amount of the Sinking Fund on January 1, 1902, was, in round numbers, $89,000,000., and the outstanding city stock entitled to the benefit of the Sinking Fund, maturing between that date and 1928 amounted, in round numbers to $149,000,000. It also appears that the estimated revenues of the Sinking Fund during the year 1902 exceed the amount of an annual amortization instalment which, with interest, would be required to retire all outstanding obligations of the (old) City of New York, entitled to the benefit of the Sinking Fund referred to at maturity, by about the sum of $8,500,000. The plan proposed is that in each year the Sinking Fund Commissioners shall certify to the Board of Aldermen the estimated amount of revenues of the Sinking Fund during such year and shall also certify the sum which, with the accumulations of interest thereon (at a rate not specified) shall be sufficient, when made annually on the same basis, to meet and discharge when due all bonds and stocks redeem-

able from the "Sinking Fund of the City of New York for the redemption of the City debt;" that the Comptroller shall thereupon issue certain obligations to be called "General Fund Bonds," which shall be issued only to the Commissioners of the Sinking Fund, to the amount of the difference between the two sums above referred to, receiving from the Sinking Fund the amount of such difference, which amount may then be applied to meet the current expenses of the City government and which shall reduce by so much the amount to be raised by taxation; that these "General Fund Bonds" shall be cancelled at the time when all the bonds and stock outstanding entitled to the benefit of the Sinking Fund of the City of New York for the redemption of the City debt shall have matured, provided all of such stocks and bonds shall have then been paid, or an offer to redeem such stocks and bonds has been made and sufficient funds to do so retained to the credit of such Sinking Fund.

In other word, the plan proposed is that all of the annual revenues of the Sinking Fund in excess of an annual amortization amount, ascertained as above described, shall be paid into the treasury of the City for use in the general purposes of government, and the City shall deposit in the Sinking Fund its "I. O. U's" or so-called "General Fund Bonds" to the amount so paid.

In determining the validity of this scheme, we must first ascertain the terms of the contract creating the Sinking Fund and defining the powers of the Commissioners with respect to it.

The ordinance of 1844 enacts that all money theretofore received and thereafter to be received from certain designated sources are thereby pledged, appropriated to and constitute and form a fund called "The Sinking Fund of the City of New York for the redemption of the City debt" until the whole of the stocks of the City of New York shall be finally and fully redeemed.

Sec. 4 enacts as follows,—

> "The said commissioners shall, from time to "time, invest the moneys which shall constitute "the sinking fund for the redemption of the city "debt, or so much as they can, in the purchase of "stocks created by the corporation of the City of "New York at the market price not exceeding the "par value thereof; and if at any time such in-"vestments cannot be made at par then the said "commissioners shall be authorized to invest the "said moneys, or such part thereof as they may "see fit, either in the purchase of the said stock, "or the stock of the State of New York, or the "stock of the United States, notwithstanding "such stocks may be above the par value thereof."

Subsequent actions require the Commissioners to give preference to the purchase of City stock, if the same can be procured at a reasonable rate; authorizes them to sell State or United States bonds which may be held and to invest the proceeds in City stock, (provided that City stock purchased shall not be cancelled until the final redemption of the said stock) and that all interest accruing thereon shall be regularly carried to said Sinking Fund for the redemption of the City debt, and authorizes the temporary investment of unemployed moneys in temporary bonds of the City.

The purpose or intention of the City and the legislature in creating the Sinking Fund and enacting the provisions above referred to concerning it was stated in the preamble to an earlier Sinking Fund ordinance passed August 9, 1813, which Judge DANFORTH in *Bank for Savings v. Grace* (102 N. Y., 313) considered might be said to state the ground and cause of creating such a fund, and to be

> "'a key to open the minds of the makers of the "'act' so that what was really intended by it "may be seen."

That ordinance after reciting that

> " WHEREAS it is highly useful to establish a
> " fund out of which purchases of the New York
> " City stock may, from time to time be made,
> " whenever the same can be done at par, or the
> " true value thereof, whereby the said stock will
> " be prevented from depreciating and the redemp-
> " tion of the same will be regularly progressing."

enacted that all moneys derived from certain specified sources.

> " * * * shall be and hereby are firmly and
> " inviolably pledged, appropriated and applied to
> " and constitute and form the fund for the pur-
> " pose aforesaid until the final redemption of the
> " whole of the said stock."

The utility anticipated by the City in establishing this fund is said, by Judge DANFORTH in the case above cited, to be, first, *redemption*, so far as the money in hand would go, and, second, *the maintenance of the market value of the unredeemed stock.*

> " Re-purchase of notes or other evidences of
> " debt by the issuer from the holder," he says,
> " is redemption and is equivalent to and has the
> " force of payment."

And the court held that the purpose of the provisions in in the ordinances authorizing the application of moneys in the Sinking Fund to the purchase of City stocks was to thereby bring about the gradual reduction of the outstanding debt of the City, and so increase the value of the remaining unredeemed stocks.

If there were no further provisions in the statute or the ordinances bearing upon the subject and the matter rested entirely upon what has been stated above, the inquiry would be very easily answered for the plan under consideration would certainly involve a departure from the original contract obligation, because to the

extent of the amount invested in the so-called " General Fund Bonds " the moneys of the Sinking Fund would be applied, not for the purpose of *retiring* outstanding debt, but for the purpose of *creating* additional debt, and simply as a contribution to the current expenses of government. The so-called " General Fund Bonds " being issued by the City directly to the Sinking Fund acquire no legal inception as *bonds* but are simply evidence of a loan from the Sinking Fund to the City, that is from the City to itself. (See *Brownell v. Greenwich*, 114 N. Y., 518; *Hoag v. Town of Greenwich*, 133 N. Y., 152; *Ahern v. Goodspeed*, 72 N. Y., 108; *Coddington v. Gilbert*, 17 N. Y., 489.) and it can hardly be doubted that such disposition of the moneys would not be a " purchase " of stocks created by the corporation of the City of New York at the market price, within the meaning of the ordinance of 1844. But in the Act of 1878 the legislsture went further and although it first in very emphatic language declared that all the moneys and revenues of the City theretofore pledged and appropriated to and constituting the Sinking Fund should continue to be so pledged and appropriated, and that nothing in the Act contained should be held to require or authorize the Commissioners of the Sinking Fund to use any portion of it,

> " in any manner whatever whereby the security of
> " said fund for the payment of the bonds and
> " stocks of said city for which said fund is now
> " pledged by law and which a charge on said fund
> " shall be alienated or impaired," (Sec. 5)

it then proceeded, in Section 10, in effect to authorize the Commissioners of the Sinking Fund to purchase from the City directly, without previous public offering, any bonds or stocks of the City of New York which it might at any time be authorized by law to issue. The language used is

> " Whenever any bonds or stocks herein author-
> " ized to be issued, or any bonds or stocks of the

" City of New York, as provided by law shall be
" hereafter issued, other than revenue bonds, *or*
" *such bonds or stocks as may be purchased for in-*
" *vestment by the Commissioners of the Sinking*
" *Fund*, the Comptroller of the City shall invite
" proposals therefor by public advertisement
" * * * and shall award the same to the high-
" est bidder therefor."

This is a distinct legislative recognition of the right of the Commissioners of the Sinking Fund to invest by direct purchase from the City, and as a matter of fact we are informed by the Finance Department that since the first of January, 1892, the aggregate of temporary and permanent investments made by the Sinking Fund exceeds $145,000,000., of which only $1,895,-659.84 were in bonds purchased from *outside* holders, the balance being all taken directly from the City at the time of their issue, and that the same practice had continued long prior to 1892, the custom being for the Sinking Fund Commissioners to take bonds at par, bearing three per cent interest per annum whenever they could do so,—bonds issued to the public in almost every instance bearing not less than three and a half per cent interest, and selling at a premium. This statute, as construed by long continued custom, amounts therefore to a legislative authorization embodied in the contract creating the Sinking Fund, to the Commissioners of the Sinking Fund to lend the moneys accumulated in such fund to the City of New York in all cases where the City is authorized by law to incur indebtedness and issue its stock to the amount thereof.

Now, except as restricted by the provisions of the Constitution of the State, there is nothing to prevent the legislature from authorizing the City to borrow money for any purpose whatever, and to issue its obligations for the money so borrowed. The State Constitution has imposed but three restrictions upon the exercise of such power. It has forbidden the City

to lend its money or credit in aid of any individual, association or corporation; it has forbidden it to incur any indebtedness "except for city purposes," and it has restricted the amount for which it may become indebted to a certain percentage of the assessed valuation of its real estate (Constitution, Art. 8, Sec. 10). There is nothing in the Constitution to prevent the legislature from authorizing the City to borrow the entire amount of money necessary to conduct the City government (to an amount restricted by the debt limit provision in Art. 8, Sec. 10) for one or more years without imposing any tax levy whatever, until the maturity of such loan; and if it should do so, the stock or bonds issued by the City as evidence of such loan would be its valid obligations, and by force of Sec. 10 of the Act of 1878 above referred to (and which is now embodied in Sec. 182 of the Charter of the present City) might be purchased by the Commissioners of the Sinking Fund directly from the Comptroller and without previous offering to the public.

It is true that this practically destroys the entire actual security supposed to be created by the Sinking Fund and leaves it open to the legislature to destroy entirely the whole benefit of the Sinking Fund; for if it can authorize the application of any part of it to the payment of current expenses of government, it may permit all to be so applied, and the truth is, as the Comptroller says in his letter of September 22nd above referred to,

" that sinking funds *such as exist in the City of*
" *New York*, the assets of which are invested
" wholly in the obligations of the City, are only in
" name and in tradition any security to the bond-
" holders of the City, for all that the bondholder
" really has, however replete the sinking fund may
" be, is the good faith and credit of the city it-
" self."

If it be objected that such a construction is absolutely at variance with the declared purpose of the

Sinking Fund contract as construed by the highest court; that a Sinking Fund which is subject to destruction at the will of the debtor is of no utility, but a mere delusion; that, as the Supreme Court of Minnesota said in condemning a proposed application of the Sinking Fund provided for the redemption of the debt of the City of Minneapolis to the purchase of bonds directly from the City,

> " To construe the law so as to authorize such a
> " sale would make the sinking fund *a debt-creating*
> " *instead of a debt-paying scheme*,"
>
> *Kelly vs. City of Minneapolis*, 63 Minn. Rep., 125,

the answer is that the terms of the contract expose it to such application, and the bondholder must rely upon the good faith of the legislature to see that nothing is authorized which, under color of compliance with his contract, is actually destructive of it.

The effect of a precedent in dealing with the Sinking Fund in the method proposed is also a matter for legislative consideration. It should, however, be distinctly understood that while in *form* authorizing an issue and purchase of bonds, in *substance* and truth, the plan proposed is nothing but an application of a certain portion of Sinking Fund moneys towards the general expenses of City government; an application not towards the reduction of city debt, but to the relief of taxation, a purpose which though permitted by the *letter* of the contract, is certainly contrary to the purpose it was designed to accomplish.

We have dealt in this opinion with the question of legislative *power* to authorize the carrying out of the proposed plan.

The form of suggested amendment to the Charter of the City to enable the accomplishment of the purpose may require modification and no doubt the city officials would entertain any suggestions which bondholders might have to make. The bond proposed to be issued

should, it would seem to us, be a real and not a sham obligation. It should bear a stipulated rate of interest. It should be such a bond as the Commissioners of the Sinking Fund might sell if at any time it became necessary to provide funds to meet maturing obligations. The rate of interest at which the amortization instalments are to be calculated should be fixed. These are, however, merely details involved in carrying out the plan and their consideration is not properly a part of this opinion.

In summing up, therefore, we may adopt the carefully guarded language of the Corporation Counsel and say that the plan, if authorized by the legislature, would be "technically legal."

New York, December 10, 1902.

Very truly yours,

(Signed) STRONG AND CADWALADER.

MSH 20822

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